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Coffee Production Rebound Promising, but Sector Challenges Remain

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Report Highlights:
Better weather conditions and the first harvests of the rust resistant varieties replanted in 2010 are supporting a production recovery after three years of yields decimated by excessive rains and the aggressive spread of coffee rust or the fungus (*Hemileia Vastatrix)*. Post forecast is that coffee production will rebound to 8.3 million bags (1 bag = 60 kilograms – unless otherwise noted) in marketing year (MY) 2012/13, up eight percent from the previous year, increasing further to 9 million bags for MY 2013/14. On the other hand, lower international and domestic coffee prices, increasing production costs and less price competitiveness due to a strong Colombian peso (CP) have squeezed

grower margins to the point of not being able to break even. Demanding government action, the economic issues impacting the sector resulted in upheaval with growers conducting week-long countrywide protests and road blockades in February/March 2013. The protests motivated the Government of Colombia (GOC) to act by establishing additional subsidies to ease the economic burden to growers.

Executive Summary:

Post estimates that Colombian coffee production will increase to 8.3 million bags in MY 2012/13 (October through September), up from 7.6 million bags the year before. Production is forecast to increase further in MY 2013/14 to 9 million bags. The apparent production recovery follows about four years of yields challenged by inclement weather from the *la Niña* phenomenon and the spread of coffee rust. To control the spread of rust, Colombian coffee growers have replanted approximately 300 thousand hectares of coffee from 2010 to 2013 with rust resistant varieties. The first replanting efforts of 2010 are now entering a phase of economic viability with approximately 110 thousand replanted hectares currently being harvested. Replanting efforts with rust resistant varieties and the return to more normal weather conditions are supporting a production recovery demonstrated by a 41 percent increase in coffee production in April 2013 calendar year to date.

The result of the February/March 2013 coffee grower protests and road blockades was a GOC increase in subsidies to the coffee sector. A new program titled Protection for the Income of Farmers (PIC) will provide growers a direct payment per bag subsidy to compensate for the currently low "guaranteed price" paid to producers. The guaranteed price is set by the National Federation of Colombian Coffee Growers (FEDECAFE) and based on the daily quote of the New York Coffee, Sugar and Cocoa Exchange (NYCSCE) less an estimated cost of internal transport.

Colombian coffee exports will parallel production gains. In MY 2012/13, Post estimates that exports will reach 8.2 million bags, increasing further for MY 2013/14 to 8.9 million bags.

Commodities:

Coffee, Green

Production:

There are two peak harvest periods during a calendar year of coffee production: the main harvest period from October to December, produces 60 to 70 percent of total production; and, the second harvesting period from April to June, or the "mitaca" crop, harvested mainly in the central coffee region of Colombia. There are 553 thousand coffee farmers in Colombia, of which 95 percent produce on less than 5 hectares of land. Small farmers with less than 5 hectares of land are responsible for approximately 69 percent of total coffee production in Colombia.

Post forecasts that Colombian coffee production will increase to 8.3 million bags in MY 2012/13, eight percent higher than the previous year. The rust resistant coffee varieties replanted in 2010 have become economically viable nearing mature productive capacity. Coffee replanting that occurred in subsequent years will reach productive maturity later in 2013 supporting further increases in production. In MY

2013/14, production will reach 9 million bags. The *la Niña* weather phenomenon seems to have passed and weather conditions appear to be returning to normal, another factor supporting a production recovery. Nevertheless, forecasts still fall short of the historical production levels of 10 million bags going back to 1970.

The spread of coffee rust affected about 40 percent of the planted area from 2009 to 2011. In addition, three years of excessive rains from the *la Niña* phenomenon negatively impacted production, most critically through creating ideal moisture conditions supporting the spread of rust. The combined impact of coffee rust and excessive rains reduced productivity from 16 to 11 bags per hectare between 2007 and 2012. A coffee replanting program that began in 2010 with the rust resistant *Castilla* variety, combined with other methods of disease control and improved weather, appears to have managed and reduced the impact of the coffee rust. Colombian growers regularly replant on a rotating schedule across landholdings, removing older, less economically viable trees from production. Not all replanting in recent years has been with the *Castilla* variety and farmers have expressed concerns with the *Castilla's* productive efficiency, in terms of kilograms of green coffee per tree, and low cupping quality, a key factor for selling to the the premium coffee markets. Many farmers, as a result, continue to plant traditional varieties while applying other methods of disease control, such as the application of fungicides. As well, defensive replanting, such as creating an outer buffer of disease resistant varieties, with more traditional varieties within that buffer, is another method to minimize the impacts from rust.

Expectations are that this recovery may prove sustainable. The 2010 rust resistant replanting efforts are now beginning to show results, benefitting further from more normal weather conditions. As a result, coffee rust has only impacted seven percent of planted area in 2012, according to FEDECAFE. This recovery is evidenced by the increase in monthly harvest data year-on-year (y-o-y). Coffee production in MY 2012/13 up to April 2013 reached 6.1 million bags, a 35 percent increase from the same period a year before. Nevertheless, weather is a critical factor supporting the recovery and FEDECAFE's Center for Colombian Coffee Research (CENICAFE) remains concerned with weather variability due to climate change, predicting a possible return of excessive rains after August 2013.

Other production threats remain, such as the coffee cherry borer, or *broca*, and an influx of spider mites as a result of a volcano eruption that decimated the population of lady bugs and other of beneficial insects. Entomologists at CENICAFE are working with extension agents on recommending chemical controls for spider mites, but do not appear to be too concerned about any significant impacts on production given that they are already observing a rebound in the beneficial insect population.

Rising input costs for harvest laborers, fertilizer and chemical pesticides to address coffee rust and insect pests like the *broca*, combined with low prices paid to growers, have effectively squeezed margins to the point of unprofitability. Labor represents about 40 percent of production costs. According to Post sources, labor costs, critical for harvesting, have risen 10-20 percent in 2013. Utility expenses, such as water and electricity, important for processing coffee, have also increased. The rising costs of labor and utilities have forced producers to make sub-optimal decisions regarding purchasing and using other inputs, such as fertilizers and chemical pest controls, which are key to maintaining coffee quality and export competitiveness.

Consumption:

Post estimates coffee consumption at a trivial 1.2 million bags. Local coffee consumption is driven by an increasing number of “Juan Valdez” coffee shops or cafes owned by a private consortium associated with FEDECAFE. The Juan Valdez cafes offer a variety of coffee and espresso drinks. Other companies with a presence in this market include Illy and OMA. All cafes are oriented towards satisfying the coffee beverage preferences of young professionals. Although processed and consumer oriented high quality coffee sales have increased in recent years, the Colombian consumption of green coffee remains marginal.

Trade:

In MY 2012/13, Post forecasts Colombian coffee exports will increase to 8.2 million bags, up 12 percent from the previous year. Colombian coffee exports for the 2013 calendar year are expanding significantly in the first quarter with exports increasing 25 percent y-o-y, according to FEDECAFE. Post expects Colombian coffee exports increase further to 8.9 million bags in MY 2013/14, paralleling the recovery in coffee yields. Trade issues with a strong currency may abate, as the GOC is attempting to manage monetary and fiscal policies that will weaken the Colombian peso in support of exports.

The United States is the major single destination for Colombian coffee, importing 42 percent of all Colombian coffee exports, with the Japan, Belgium, and Canada importing 10, 7 and 7 percent, respectively.

As part of a quality differentiation and improvement policy, Colombia is increasingly exporting high quality coffee that meets the cupping and grading expectations for certification that capture more value added. Value added coffee products, in particular specialty coffees, now make up 36 percent of Colombia’s total exports. Colombian specialty coffee is booming with certified and organic coffees receiving significant price premiums, priced typically higher than traditional coffee exports. Coffee origin labels from specific regions of Colombia, such as Huila and Nariño, are being pushed by the GOC as a strategy for more international recognition and further value added. Colombian specialty coffee growers produce coffee under numerous international programs that provide fair trade and organic certifications such as USDA Organic, UTZ Certified, 4C, and Rainforest Alliance. Protocols vary between growers to maintain the levels of quality that will meet certification standards and continue to be recognized by international buyers. Colombian coffee growers understand value added and quickly incorporate new best practices in production and intermediate processing that will insure high cupping scores and secure premium prices in niche international markets. At the 2012 Colombia Cup of Excellence, a small-scale, female specialty coffee grower from the southern department of Nariño won the event, receiving US$22.00 per pound for her entire harvest.

According to the International Coffee Organization, average prices for March 2013 fell 71 percent y-o-y. This price erosion was reflected in domestic Colombian prices. In March 2013, and for the second consecutive year, local prices to growers decreased 31 percent y-o-y. In 2012, the Colombian peso appreciated on average 3 percent against the dollar effectively deteriorating Colombian coffee grower income from less competitively priced coffee in international markets.

Stocks:

There are no price incentives to hold inventories in Colombia and the international market price for Colombian coffee is will not likely rally upward. There exists no GOC or FEDECAFE policy to support large scale carry-over stocks of coffee. The calculated inventory of coffee at the end of MY

2012/13 will total a trivial 249 thousand bags, or about 3 percent of total production. In MY 2013/14 inventory is expected to not change and remain at about 250 thousand bags.

Policy:

The coffee sector has historically played a large role in Colombia's economic success, providing a livelihood for over 500 thousand producers and their families and giving FEDECAFE significant political influence. A majority of growers are members of FEDECAFE and take advantage of the organization's educational programs, technical training, and sales support. FEDECAFE purchases coffee from its members at an internal price which parallels the international commodity market less some administrative and internal transport expenses. Coffee producers claim that current production costs are estimated at about CP$750 thousand (US$425) per 125 kg bag of green coffee. As of January 2013 the internal FEDECAFE price per bag plummeted to CP$525 thousand (US$295), creating an unprofitable environment for growers. The fall in price has been exacerbated by a strong Colombian peso, which appreciated about 45 percent vis-a-vis the U.S. dollar over the past four years. With about 42 percent of Colombian coffee exports destined to the United States, growers are receiving less local currency per bag while input costs continue to rise.

Colombian coffee growers, facing considerable financial difficulties, initiated protests on February 25, 2013 to demand that the GOC recognize the sector's hardships and provide financial assistance. Approximately 80 thousand growers protested for 12 days, blocking roads and causing a national media sensation. Roadblocks created gasoline shortages in some towns and caused at least two deaths as ambulances were not allowed to pass through protestors. The leaders of FEDECAFE publicly distanced the organization from the protestors and their methods. The GOC began negotiating directly with the protestors while FEDECAFE remained largely on the sidelines. The negotiations resulted in an agreement by the GOC to establish a minimum internal floor price per bag paid to growers and an increased subsidy in the form of a direct payment to close the gap between the floor price and the growers' break-even point. The protests ended on March 8, 2013.

Colombia's coffee sector has enjoyed the highest level of GOC financial support and subsidies among agricultural sectors between 2010 and 2012 with a total of CP$3.4 billion (US$2 million) in subsidies and financial assistance. The new subsidy agreement, entitled Protection for the Income of Farmers (PIC), took effect on March 18, 2013, and ensures growers a minimum internal floor price of CP$480 thousand (US$270) per 125 kg bag and an additional CP$145 thousand (US$80) per bag in the form of a direct payment. If the international coffee price falls below CP$480 thousand the total amount of GOC financial assistance will increase through 2013. Conversely, the GOC will reduce the amount of subsidies if the price rises above CP$700 thousand (US$395). With total financial support of CP$625 thousand (US$353), the subsidy may fall short of ensuring that growers will break-even, since many producers claim a production cost of CP$750 thousand (US$425) per bag.

Other GOC and FEDECAFE programs to assist growers have focused on controlling coffee rust with the long-term goal of restoring coffee production to historical averages above 10 million bags. FEDECAFE manages low interest loan programs for the costs of replanting; however, loans are allegedly only offered for planting rust resistant varieties. This has caused some discontent with growers that would like access to loans to plant other varieties, given issues with the yields and cupping quality of rust resistant varieties. The GOC also offers financial assistance for all agricultural commodities through the Rural Funding Incentive which provides loans with discounted payback terms.

After the upheaval, FEDECAFE leaders from the regions of Antioquia, Caldas and Cundinamarca, responsible for about 30 percent of Colombia's total coffee production, publicly demanded that FEDECAFE General Manager, Genaro Muñoz, step down due to his lack of leadership during the crisis. On April 30, 2013, FEDECAFE held a supplemental meeting of members to assess the problems facing the sector and the regional bloc officially called on General Manager Muñoz to resign. In the end, the regional bloc failed to garner enough support among all regions to remove Mr. Muñoz; nevertheless, the disunity within the Federation may create additional obstacles to overcoming the sector's current challenges.

Production, Supply and Demand Data Statistics:

Coffee, Green Colombia	2011/2012		2012/2013		2013/2014	
	Market Year Begin: Oct 2011		Market Year Begin: Oct 2012		Market Year Begin: Oct 2013	
	USDA Official	New Post	USDA Official	New Post	USDA Official	New Post
Area Planted	780	780		780		780
Area Harvested	640	640		640		640
Bearing Trees	2,900	2,900		2,900		2,900
Non-Bearing Trees	1,070	1,070		1,070		1,070
Total Tree Population	3,970	3,970		3,970		3,970
Beginning Stocks	99	99	249	249		249
Arabica Production	7,655	7,655	7,500	8,300		9,000
Robusta Production	0	0	0	0		0
Other Production	0	0	0	0		0
Total Production	7,655	7,655	7,500	8,300		9,000
Bean Imports	1,050	1,050	900	1,000		1,000
Roast & Ground Imports	0	0	0	40		40
Soluble Imports	55	55	60	60		60
Total Imports	1,105	1,105	960	1,100		1,100
Total Supply	8,859	8,859	8,709	9,649		10,349
Bean Exports	6,675	6,675	6,500	7,400		8,100
Rst-Grnd Exp.	25	25	25	25		25
Soluble Exports	610	610	600	775		780
Total Exports	7,310	7,310	7,125	8,200		8,905
Rst,Ground Dom. Consum	1,000	1,000	1,000	900		900
Soluble Dom. Cons.	300	300	300	300		300
Domestic Use	1,300	1,300	1,300	1,200		1,200
Ending Stocks	249	249	284	249		244
Total Distribution	8,859	8,859	8,709	9,649		10,349
Exportable Production	6,355	6,355	6,200	7,100		7,800